CARBON MARKET BUSINESS BRIEF

WASHINGTON STATE

WASHINGTON STATE CAP-AND-INVEST AT A GLANCE

Years in Operation	28-year programme broken into seven four-year compliance periods First compliance period begins in 2023
Overall Cap & Trajectory	The Department of Ecology has assigned a temporary total programme baseline value of 71 million tCO_2e for the first compliance period, and must set a final value by 1 October 2022.[1] Allowance budgets are provisionally expected reduce by 7% reduction per year during the first compliance period, as follows:[2] • 66.03 million tCO_2e in 2023 • 61.06 million tCO_2e in 2024 • 56.09 million tCO_2e in 2025 • 51.12 million tCO_2e in 2026
Target(s)	• 45% below 1990 levels by 2030 • 70% below 1990 levels by 2040 • 95% below 1990 levels by 2050 The programme is expected to account for 52.4% of Washington abatement efforts through 2030 (26.2 $MtCO_2e$ of the required 50 $MtCO_2e$ emissions reduction target).[3]
Sectors covered	As of 2023: • Gasoline and on-road diesel • Electricity generation (including imports) • Large stationary sources that emit over 25,000 tCO2e annually • Natural gas distributed to homes and commercial businesses As of 2027: • Waste to energy facilities As of 2031: • Railroads • Landfills that do not otherwise capture landfill gas through waste decomposition methods or convert the gas into renewable natural gas or electricity.

[1] Table 200-1 in draft regulation (173-446). [Footnotes for internal reference]

[2] https://ecology.wa.gov/DOE/files/5b/5bdc1ffb-01dc-49de-b0cf-e5758aa5c1f6.pdf; Table 210-1 in draft regulation

[3] https://static1.squarespace.com/static/5e9fc98ab8d9586057ba8496/t/614102b709070223af678c22/1631650493089/Department-of-Ecology-Clean-and-Prosperous-WA-Presentation-Sep-8-2021.pdf; https://wstc.wa.gov/wp-content/uploads/2022/01/2022-0119-BP3B-ClimateChangeBlueprint-Nationally.pdf

Sectors covered (continued)	Agricultural operations, forestry operations, fuels used exclusively for aviation or marine use, and entities that emit less than 25,000 tCO2e annually are not covered by the programme. [4]
GHGs covered	• CO_2 • CH_4 • N_2O • SF_6 • HFCs • PFCs • Any other gas or gases designated by the department by rule.
# of entities covered	c. 100
Allocation method	The programme distributes free ("no-cost") allowances to natural gas utilities, electric utilities, and emissions-intensive trade exposes (EITE) facilities. Allocation is determined on an individual facility basis using a variety of methods. • No-cost allowance allocation to facilities designated as EITE based on carbon intensity baseline (or mass-based baseline where carbon intensity cannot be determined). Allocations decrease by 3% of the allocation baseline for each of the first three compliance periods. • Like California, allowance allocation for electric utilities is based on the "cost burden" effect of the programme on the utilities. Allowances are consigned at auction for the benefit of ratepayers or given directly to the utility, or both. • Natural gas utilities that report GHG emissions and participate in the programme receive no-cost allowances that are either consigned at auction for the benefit of ratepayers or given directly to the utility. The percentage of allowances consigned at auction increases from 65% in 2023 to 100% in 2030.
Trading rules	The programme imposes holding and purchase limits that limit the overall quantity of allowances that entities can hold or purchase. Third-party financial entities can also participate in trading if they meet certain prerequisites.
Use of offsets and linking	Offset usage is limited to 5% during the first compliance period, and 4% during the second. At least 50% of offsets must be sourced from projects that provide direct environmental benefits within the state during the first compliance period, with that number increasing to 75% during the second compliance period (unless there is insufficient supply). An additional 3% of a covered entity's compliance obligation during the first compliance period and 2% during the second may be met through the transfer of offset credits from projects located on federally recognised tribal land. Ecology may modify the offset usage limits "when appropriate" to ensure achievement of the proportionate share of statewide emissions limits or to align with other linked jurisdictions. The Climate Commitment Act empowers Ecology to link the Washington programme with those in other jurisdictions. Ecology has already taken steps to facilitate linking with California's Cap-and-Trade Programme by framing certain elements of the draft regulations to mirror California's approach.

[4] https://ecology.wa.gov/DOE/files/5b/5bdc1ffb-01dc-49de-b0cf-e5758aa5c1f6.pdf

Price containment	The programme will institute an auction floor price and ceiling price (yet to be determined) that will increase by 5% annually plus inflation. If it links with another jurisdiction, Ecology will set an emission containment reserve trigger price at a level equal to that of the other jurisdiction. If the price ceiling is trigged, allowances from an allowance price containment reserve will be sold at separate reserve auctions. Auctions will have two different tier prices set between the emissions containment reserve trigger price and the ceiling price. If the allowance price containment reserve runs out of allowances, Ecology will print new allowances while using the corresponding revenues to invest in abatement. Ecology will maintain an emissions containment reserve to ensure prices are kept above the floor and will seed the reserve through various mechanisms, including the transfer of 2% of the annual allowance budget. Ecology will also withdraw allowances from auctions where the emission containment reserve trigger price is met. Banking is allowed; borrowing is not allowed.
Penalties for non-compliance	A covered entity must annually surrender allowances equivalent to 30% of emissions from the previous year within the current compliance period by 1 November annually. At the end of each four-year compliance period, a covered entity must surrender allowances equivalent to 100% of emissions for the compliance period, less allowances already surrendered. Failure to surrender on time results in an immediate surrender obligation equivalent to four times the missing balance. Ecology must issue an order (involving a plan and schedule for coming into compliance), a penalty of up to $10,000 per day, or both, to entities that fail to meet the surrender obligation. For the first compliance period, Ecology may reduce the amount of the penalty by adjusting the monetary amount or the number of penalty allowances not timely provided.
Use of revenues	Revenue from consigning no-cost allowances given to electricity and natural gas utilities will be used for the benefit of ratepayers while all other revenue will further the state's emissions reduction targets, address the impacts of global warming on affected habitats, species, and communities, support industry sectors that sequester emissions, and increase investment in the clean energy economy. These investments will be managed through the following accounts: • Carbon Emissions Reduction Account, capped at $5.2 billion through FY2037 and half of auction proceeds thereafter, for emission reduction programs in the transportation sector (eg, transportation alternatives, alternative fuel infrastructure, freight transportation improvements). • Climate Investment Account, to support climate mitigation, adaptation and resilience programmes. 75% is initially allocated to the Climate Commitment Account and 25% is initially allocated to the Natural Climate Solutions Account. • Air Quality and Health Disparities Account, intended to direct at least $20 million per biennium for programmes that improve air quality monitoring and outcomes.

MAJOR DEVELOPMENTS

The Climate Commitment Act, passed in July 2021 by the Washington State legislature, established the state's first economy-wide emissions trading system, known as the Cap-and-Invest Programme. The programme is designed to cover roughly 100 entities, accounting for 75% of the state's GHG emissions for its duration (2023 to 2050).

As the beginning of the first compliance period nears, attention is now centered around the rulemaking process led by the Department of Ecology, the agency responsible for implementing and overseeing the programme. The rules developed throughout the coming months to give effect to the Act will address issues relating to allowance budgets, procedures governing allowance allocation, allowance auction mechanics, the use of carbon offsets, the protocols governing carbon offset projects, and enforcement mechanisms, among others. As the rulemaking is an ongoing process, this brief reflects the status of the rules as of the date of publication.

The programme includes a number of elements designed to ensure that "overburdened communities" (geographic areas where racial minorities, low-income populations, and populations disproportionately at risk or impacted by environmental harms face the combined effects of environmental pollutants and contaminants) receive the benefits from allowance auction revenues and are not negatively affected by the activities it is regulating. These elements include:

- Annual environmental justice assessments to ensure that at least 35% of cap-and-invest revenues benefit vulnerable populations in overburdened communities.
- Biennial assessments to ensure air quality improvements in overburdened communities. In the absence of improvements, imposition of stricter air quality standards, emissions standards or emissions limitations on criteria pollutants. Ecology may also, in consultation with the environmental justice council, reduce offset limits for covered entities substantively contributing to pollution.
- An environmental justice council to oversee and advise on the programme's development and implementation.
- A requirement that linkage with another cap-and-trade programme not adversely affect overburdened communities in both linked jurisdictions.
- A community engagement plan to ensure representation of vulnerable populations, overburdened communities and marginalised communities in the Governor's oversight of the Climate Commitment Act.

MARKET COMMENTARY

The rulemaking process involves three proposed rules that address different key elements: (1) Chapter 173-446 WAC, which covers all aspects relating to the programme structure and operation, including registration requirements, methods and procedures for allocating allowances, allowance budgets for the first compliance period, auction registration requirements and price containment, procedures for offset projects, transfer and sale of allowances, among others), (2) Chapter 173-446A WAC, intended to establish criteria to identify EITE industries that will be eligible for no-cost allowances, and (3) Chapter 173-441 WAC, defining various reporting and verification requirements and related matters.

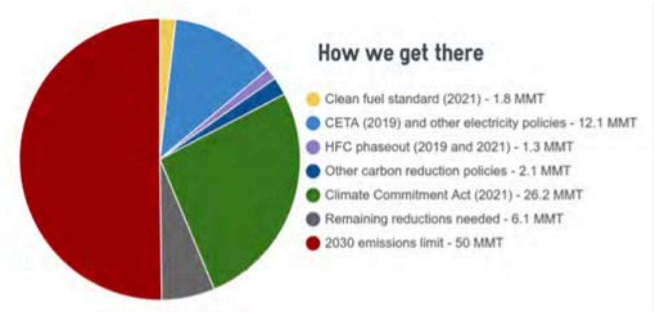
As reflected in Figure 1, the rulemaking process is projected to take place throughout 2022 and conclude in Q4 2022 with the adoption of Chapter 173-446 WAC. The programme will launch shortly thereafter, concurrently with the Clean Fuels programme, discussed below.

FIGURE 1: CCA Rulemaking Timeline

Sept. 8, 2021 Dept. of Ecology Climate Commitment Act Overview

The Clean Fuels Standard (CFS) is intended to work alongside the Cap-and-Invest Programme to target the transportation sector, which accounts for 45% of Washington's total emissions. The CFS is also undergoing rulemaking in 2022, and ultimately will likely mirror similar rules in existence in California, Oregon, and British Columbia. As shown in Figure 2, the Cap-and-Invest Programme is intended to account for the majority (52.4%) of emissions reductions through 2030, while the CFS and other complementary emissions reduction policies act in an auxiliary capacity.

FIGURE 2: WA Approach to Emissions Reduction through 2030



Jan. 19, 2022 Dept. of Ecology Climate Commitment Act Implementation Update

USEFUL LINKS

Climate Commitment Act

Chapter 173-446 WAC

Chapter 173-446A WAC

Chapter 173-441 WAC

Overview of Washington's Climate Policies

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